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SUBJECT: PARIS CLUB - MAY 2009 TOUR D'HORIZON AND DISCUSSIONS ON
METHODOLOGICAL ISSUES

¶1. (SBU) Summary: During the May 13 Paris Club meeting, creditors were willing to extend Afghanistan's debt treatment, but Russia blocked the move. Paris Club members expressed concerns about Brazil's proposed loan to Argentina's state-owned airline Aerolineas Argentinas, but agreed to seek more information before taking action. The Central African Republic (CAR) appeared on track to complete the Heavily Indebted Poor Countries (HIPC) Initiative in June. Delegations as well as IMF and World Bank representatives were highly skeptical that the Republic of Congo's (Brazzaville) $800 million settlement with litigating creditors ("vulture funds") can be deemed comparable to HIPC treatment. Creditors reluctantly agreed to extend Grenada's 2006 treatment to reschedule payments due in 2009. The IMF and World Bank appear determined to bring Haiti to "Completion Point" soon by seeking a waiver of the public procurement law trigger, which requires not only passage of the law but implementation for six months. The Paris Club entered into force the second phase of Liberia's 2008 interim treatment.

¶2. (SBU) The IMF reported that Moldova is expected to seek Paris Club treatment together with an 18-month loan program. France and Italy, the two holdouts that had not participated in Peru's 2007 prepayment arrangement, agreed to accept prepayment now on the same terms. While some creditors supported the Secretariat's draft paper on creating a class of senior debt for bilateral loans linked to IMF programs, there was also considerable skepticism. On May 14-15, the

Paris Club negotiated with Cote d'Ivoire an interim debt treatment following the country's entry into the HIPC Initiative process. Under the new Agreed Minutes, $845 million will be cancelled over the next three years. End Summary.

Afghanistan

¶3. (SBU) The IMF reported its Executive Board's April 22 approval of the fifth review and Poverty Reduction and Growth Facility (PRGF) program extension to March 2010. Afghanistan had asked the Paris Club to provide a similar routine extension of its debt relief treatment to match this period. Russia, which in April had reported a "small technical problem" vis-a-vis Afghanistan, refused, initially questioning whether the Afghan authorities had even made a formal request. When the Secretariat replied that the April 26 formal request had been circulated, Russia complained that Afghanistan had not provided a report recently on its progress in obtaining comparable debt relief from non-Paris Club creditors. The U.S. asked whether provision of such a report would be sufficient; the Russian delegate said that he did not have a mandate to support extension. He said Afghanistan's performance on its PRGF program had been weak and cited the "conditionality principle." Paris Club Co-Chairman Coeure responded forcefully that the IMF Executive

Board, not the Paris Club, is the venue for discussing PRGF program performance, and the IMF Executive Board had deemed Afghanistan's performance satisfactory and approved the recent review. Coeure agreed to seek an update from Afghanistan on comparability of treatment so that the Club can agree in June to extend the interim treatment. The Fund and Bank reported that Completion Point under the HIPC Initiative could be reached by the end of 2009.

Argentina

¶4. (SBU) The U.S. had asked the Secretariat to place Argentina on the agenda to discuss a proposed Brazilian loan to the state-owned Aerolineas Argentinas or its subsidiary, Austral. During the discussion, at which the Brazilian delegate was not present, the Netherlands' representative, who also chairs the OECD Export Credit Group, reported that the OECD had already dealt with the proposed loan and that it was important to separate OECD issues from Paris

Club ones. She also indicated that there was some uncertainty about the situation, including whether the loan had been agreed before the airline had been nationalized and whether the airline could still be treated as a private entity. She also argued that there was a precedent for excluding commercial aircraft from Paris Club treatment, noting a loan to Indonesia's Garuda.

¶5. (SBU) All agreed that the Paris Club had legitimate concerns, since members had an informal agreement not to lend to Argentina. Sweden pointed out, however, that the understanding was not binding, and few of the national agencies represented at Paris Club meetings could constrain their country's respective export credit agencies. Germany commented that the Club's "gentlemen's agreement" was not binding, but expressed interest in implications for the Paris Club's outreach policy. The U.S. relayed Brazil's statements from the April 21 OECD discussion that, since Brazil was not a member of the Paris Club, it was not bound by Paris Club agreements. Furthermore, Brazil had argued that Argentina was current in payments to Brazil. The U.S. also noted that creditors that wish to cooperate with the Paris Club, including participating in methodological discussions, should support the Paris Club's positions and principles. The Secretariat intends to ask Brazil for further details on the proposed loan and report back, so that creditors can consider further steps.

¶6. (SBU) The Secretariat also reported that there was "less and less" news on President Fernandez de Kirchner's pledge to pay Argentina's $8 billion owed to Paris Club creditors, noting that any weakening of creditor solidarity would worsen the situation. The IMF reported that international reserves remained robust at $46 billion in spite of an expected real GDP contraction of 1.5 percent

in 2009 and declining fiscal revenues and exports. However, Argentina did have a large external borrowing requirement -- 15 percent of GDP in 2009 -- and its sovereign risk premium, already at 1,500 basis points, could rise further.

Central African Republic (CAR)

¶7. (SBU) The IMF reported that the CAR continued to make satisfactory progress on its PRGF program, and the Bank reported that the country had fulfilled all conditions for Completion Point under the HIPC Initiative. The IMF Executive Board is scheduled to approve Completion Point on June 24, with similar action expected at the World Bank shortly thereafter. The IMF reported it was still working to obtain financing assurances for the Completion Point debt relief from at least one more of CAR's remaining external creditors: Argentina, Taiwan, and China. The Paris Club expects to hold negotiations with CAR in July or September to provide Completion Point debt relief.

Republic of Congo (Brazzaville)

¶8. (SBU) To fulfill a requirement in the December 2008 Agreed Minutes, Congo had reported to the Club that it had paid $800 million in full settlement of claims with its litigating creditors, including so-called "vulture funds." The large amount was a surprise to the Paris Club and to the IMF. Congo had reported that the total $2.5 billion extinguished under the settlement, a much larger amount of debt than previously reported, included penalties, fees and late interest. Such a transaction implied a 65 percent discount; however, the IMF and Bank representatives, as well as creditors, were skeptical. After initially refusing on the grounds

of a confidentiality clause in the settlement, the authorities later agreed to provide additional information to the Secretariat by the end of May.

¶9. (SBU) The IMF reported that the global financial crisis had had little impact on Congo in 2008 but was starting to negatively affect GDP growth and the fiscal deficit. Congo's performance under the PRGF program had been broadly satisfactory. The IMF noted, however, that Congo must implement a new petroleum pricing regime and improve commercialization of the oil industry before the first program review could occur. Congo had completed or was close to fulfilling six of eight conditions required for HIPC Completion Point, which could be approved before the end of 2009.

Cote d'Ivoire

¶10. (SBU) Following the IMF and World Bank's March 2009 approval of Cote d'Ivoire's PRGF program and HIPC Decision Point, Paris Club creditors negotiated new "Agreed Minutes" with Cote d'Ivoire on May 14 and 15. When fully implemented over three years, the multilateral debt treatment will cancel $845 million and reduce Cote d'Ivoire's debt service to Paris Club creditors by 92 percent. The negotiations with Cote d'Ivoire were unusually contentious because the country had a large stock of private sector debt that had been restructured in 1998, as well as a substantial amount of more recently contracted, so-called "post-cutoff" debt. Despite Cote d'Ivoire's unusually high capacity to pay, creditors had to reschedule some of this post-cutoff debt, which the debtor country would normally have been expected to pay on schedule.

¶11. (SBU) The May 15 Agreed Minutes provided standard so-called "Cologne terms" on pre-cutoff debts, although the U.S. will follow its HIPC policy and forgive 100 percent of arrears and amounts coming due - about $262 million over three years. Post-cutoff debts, short-term debts, and almost all interest payments will be deferred but not reduced. Negotiations also centered on the country's capacity to pay in 2009. Based on the IMF and Secretariat's analyses, the Paris Club had initially proposed that

Cote d'Ivoire pay 3.85 percent of post-cutoff arrears in 2009, as well as certain interest installments. The IMF analysis (and PRGF program) assumed that the country would be able to borrow $600 million on the West African Economic and Monetary Union (WAEMU) markets this year; the authorities argued that this was unlikely, thus reducing their ability to pay in 2009. Creditors were generally sympathetic to this argument and agreed to much lower payments (1.2 percent) in 2009 and March 2010.

¶12. (SBU) Cote d'Ivoire also committed to seek comparable treatment from its non-Paris Club creditors and, through a side letter to the U.S. delegation, to pay on schedule the single U.S. loan contracted after the June 20, 1999 Cologne G-8 summit. The Paris Club ultimately agreed to this latter arrangement because of the cutoff date specified in the U.S. HIPC legislation and the fact that the U.S. forgives 100 percent of amounts coming due on loans made prior to the Cologne Summit. However, a number of creditors questioned whether the U.S. was fulfilling its Cologne Summit commitment. The Ivoirian authorities also indicated that they would not make payments to private creditors in 2009 and reaffirmed that they will seek funding from the World Bank's Debt Reduction Facility to clear arrears on the country's private sector Brady bonds.

Djibouti

¶13. (SBU) Some Paris Club creditors continued to report problems in completing bilateral agreements to implement Djibouti's October 2008 Paris Club debt treatment. Belgium said it signed a bilateral in February, while Germany and Italy reported that they had made good progress and were close to signing. In a letter to France, Djibouti disputed certain commercial debts. Seeking a treatment more favorable than the terms of the Agreed Minutes, Djibouti indicated that it would not sign unless Spain agreed.

Grenada

¶14. (SBU) The discussion again focused on comparable treatment, and in particular whether the Club should grant a one-year extension of Grenada's May 2006 Agreed Minutes even though Grenada had not sought comparable treatment on a loan from Kuwait. After months of seeking details, the Secretariat confirmed that the loan in question had been made to the central government. Therefore, the Agreed Minutes' clear exclusion of a Dutch loan to the Port Authority could not be interpreted as justifying exclusion of the Kuwaiti loan. After discussing the issue in five meetings, the IMF indicated for the first time that its notes did reflect such an agreement to exclude

the Kuwaiti loan. Paris Club creditors expressed frustration with the lack of detailed records, reluctantly granted the requested extension, and called for proper records to avoid such problems in the future.

Guinea

¶15. (SBU) The IMF was monitoring discussions on the political situation, and in particular the international community's position. The Fund wanted to protect the gains that Guinea had made, since the country had nearly completed the HIPC Initiative just before the coup. The Fund was looking at prospects for restoring economic assistance and relief, and was discussing reengagement with members. A joint Fund/Bank mission had visited Conakry in late March, and had found the situation to be "precarious." The Bank reported that it had stopped disbursements and was also considering its course of action and talking to regional entities, including ECOWAS. Guinea had met six of ten conditions necessary to reach HIPC Completion Point and was working to meet the others; preparations were underway for a new progress report on the PRSP.

¶16. (SBU) Guinea reported $5 million in arrears to Belgium, France and the European Investment Bank. A second phase of Guinea's

interim treatment, which would have covered calendar year 2009, was conditioned on the PRGF program's third review. Since the review has not even been planned yet, the Secretariat intends to write to Guinea to convey that the phase had not entered into force and that the country was therefore required to make payments on the original schedules. A number of countries, including the U.S., reported having received letters asking for deferrals of payments to 2011. Creditors agreed that countries should not reply individually; the Paris Club's letter will serve as the response to Guinea's requests.

Haiti

¶17. (SBU) The IMF reported on the outcome of the April 14 donors' conference, and noted that a mission was in Haiti to assess performance on Completion Point triggers. The country "seemed to be" on track and could reach Completion Point around mid-2009. The Bank's detailed readout included the June 30 Executive Board date and echoed the Fund's information on performance but neglected to

mention the status of the requirement that Haiti adopt and implement a public procurement law for six months prior to Completion Point. When the U.S. asked about it, the Bank representative indicated that he had no information; the following day he reported that Bank staff

was indeed planning to seek a waiver of that performance requirement.

Liberia

¶18. (SBU) Following the IMF Executive Board's May 7 approval of the second review of Liberia's PRGF program, the Paris Club agreed to enter into force the second stage of the country's interim treatment. The Fund reported that the global slump was affecting Liberia through lower demand and commodity prices. The authorities had little space for counter-cyclical fiscal or monetary policy because of the country's high levels of debt and dollarization, respectively. Nevertheless, Liberia's performance under the PRGF program was satisfactory.

¶19. (SBU) Liberia had made excellent progress in reducing its debt stock. Liberia completed its World Bank and USG-supported commercial debt buyback operation with 97.5 percent participation. Liberia has also signed debt restructuring agreements with all creditors except for four non-Paris Club bilateral creditors. Although external debt had fallen below $2 billion, Liberia remained in debt distress. Once Liberia completes the HIPC Initiative, its debt levels will fall well below HIPC thresholds as long as it

maintains robust growth and controls new borrowing. The Fund reported Liberia had made significant progress toward fulfilling the HIPC performance requirements, with public sector reform the single difficult issue remaining. The authorities hoped to reach Completion Point by the end of 2009.

Moldova

¶20. (SBU) The IMF reported that Moldova had requested an 18-month Stand-By Arrangement (SBA), given the country's unsustainable financial situation. The new loan program's timing was uncertain, however, since there could be delays in putting the new government into place. The IMF planned to send another mission to Chisinau in late May or early June to continue discussions and expected Moldova to seek Paris Club debt relief to help finance the SBA. Although the financing gap would be large, debt rescheduling, rather than debt cancellation, was more likely. Moldova's four largest Paris Club creditors include Russia, the U.S., Germany and Japan. Russia, the largest creditor, asked about comparability of treatment, perhaps a signal of plans to raise difficulties.

Peru

¶21. (SBU) Peru had invited France and Italy, the two creditors that had not participated in the 2007 prepayment operation, to participate now on the same terms, despite the August 2007 deadline. Both indicated that they would. (Note: In May 2007, the Paris Club concluded an agreement that allowed Peru to prepay at face value up to $2.5 billion in previously rescheduled non-concessional debt falling due between 2007-2015.) The IMF reported that Peru's recent record of exceptional performance -- thirteen years of uninterrupted growth, peaking at 10 percent in 2008 -- had begun to slow in the last quarter of 2008. Financial indicators were stable,

since banks held no asset-backed securities, had limited reliance on external funding, and faced little rollover risk.

Seychelles

¶22. (SBU) During the Paris Club's April negotiations with Seychelles, the country had agreed to make a $1 million goodwill payment immediately. The Secretariat presented a working paper with three options on how the payments could be allocated. The U.S. is not a creditor.

Zimbabwe

¶23. (SBU) The Secretariat produced a working paper laying out possible steps to normalization of relations with creditors, either through HIPC or non-HIPC channels. As in previous discussions on this subject, creditors recalled that Zimbabwe was not included as a potential HIPC-eligible country during the 2006 ring-fencing process and that the lack of end-2004 data prevented an assessment of whether Zimbabwe would have met HIPC's numerical income and debt benchmarks. The IMF pointed out that preparing a HIPC debt sustainability analysis, even for informational purposes, could be seen as a signal of the international community's willingness to move to change its rules and include Zimbabwe in the HIPC Initiative. All agreed that such issues should be discussed at the IMF and World Bank; any Paris Club involvement would come at a much later stage.

¶24. (SBU) During the IMF Executive Board's May 4 discussion, directors had welcomed the emergency recovery program, but noted many downside risks. The Board had lifted some restrictions on technical assistance. The Bank also stressed the need for technical assistance and praised the government's realistic budget and strict discipline in matching monthly income and expenditures. The Bank

reported that donors believed a multi-donor trust fund was the best vehicle for moving forward, and said it would seek Board approval for such a fund in May.

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Methodological Issue:
Seniority of Crisis-Related Bilateral Financing
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¶25. (SBU) There was a lengthy but inconclusive discussion of the Secretariat's revised proposal to grant senior status to bilateral loans made in conjunction with IMF upper credit tranche programs. Some countries, most notably Japan, were generally supportive. Japan suggested as broad a scope as possible (i.e. extending the provision to World Bank-led operations) to accommodate Asian countries like Indonesia that are averse to seeking Fund programs. There was no support for this idea. Many others, including Co-Chairman Coeure, criticized the suggestion, noting the tension between this idea and the G-20's recent reaffirmation of the IMF's central role. Delegations also discussed, inter alia, how the proposal impacted the IFI's preferred creditor status, whether the proposal should apply retroactively to loans made in the last few months, what criteria should be used, and what effect the idea would have on current creditors, and on bond spreads.

¶26. (SBU) Germany was the most skeptical about the idea; the U.S. suggested that many of the subsidiary questions could be addressed through carefully considering the purpose of the loans -- whether

they were meant to complement the IMF when it was bound by lending limits, or whether it was more broadly intended to respond to the crisis. The U.S. delegation, along with several others, made very clear that it did not yet have a position on the proposal. In any case, the Secretariat will revise the paper again. Germany stressed the need to alert senior officials engaged in G-8 and G-20 channels.

Methodological Issue:
Treatment of Loan Guarantees

¶27. (SBU) The Secretariat had surveyed members on whether they provide Paris Club treatment on loan guarantees that have not been triggered by defaults. Although not all responses had been received, it was clear that different creditors used different methods. While some creditors report all guarantees and subject them to restructuring, others report non-triggered guarantees only when specifically requested in the data call. Creditors generally agreed that the approach should be uniform. The Secretariat will prepare a working paper. There could be significant implications of

forcing performing loans into default.

Methodological Issue:
June 2009 Meeting with
Private and Outreach Creditors

¶28. (SBU) The Paris Club's annual meeting with private and outreach creditors will take place on June 25. The agenda, as agreed with the Institute for International Finance (IIF), will focus on implementation of the IIF's Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets (including specifically Ecuador and likely Argentina), sovereign debt reconciliation, so-called "vulture funds" and litigation related to sovereign debt, and the Paris Club's recent activities (including Seychelles, Cote d'Ivoire and the Republic of Congo).

¶29. (SBU) The meeting will be followed by a broader conference on the crisis and its implications for emerging and developing countries, which Economy Minister Lagarde will open and close. The Secretariat explained that this meeting aims to show that the Paris Club is actively engaged in addressing the global financial crisis.

¶30. (U) For additional information on any country in particular,

please contact David Freudenwald or Nicholle Manz in EEB/IFD/OMA.

PEKALA